No. 87-836 (2)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

PAINEWEBBER GROUP, INC.,
Petitioner,

vs.

TOMMY E. PARKER, as Custodian for
KIMBERLY M. PARKER, and JAMES L. SMITH,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

1. Is it appropriate for this Court to exercise its certiorari jurisdiction to review a decision of the United States Court of Appeals for the Eleventh Circuit which neither granted nor denied a motion for class certification in an action arising under the federal securities laws but, rather, remanded the matter to the District Court for further proceedings consistent with its decision?

2. Did not the Court of Appeals for the Eleventh Circuit properly conclude that the District Court, in ruling on a motion for class certification, was not permitted to disregard the allegations of respondents' Complaint and recharacterize the case in a manner which respondents neither pleaded nor intend to prove?

3. Did not the Court of Appeals for the Eleventh Circuit properly conclude that respondents were entitled to a presumption of reliance under the "fraud on the market" theory adopted by an *en banc* panel of the predecessor to that Circuit in *Shores v. Sklar,* 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied,* 459 U.S. 1102 (1983)?

PARTIES TO THE PROCEEDING

The petitioner in this action is PaineWebber Group, Inc. The respondents are Tommy E. Parker, as custodian for his minor daughter Kimberly M. Parker, and James L. Smith.

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Tommy E. Parker and James L. Smith ("respondents") respectfully request that the Court deny the Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit (the "Petition") submitted by PaineWebber Group, Inc. ("PaineWebber" or "petitioner") to review a judgment of the United States Court of Appeals for the Eleventh Circuit which reversed in part, affirmed in part and remanded an order of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit (App. Exhibit A)[1] is reported as *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718 (11th Cir. 1987). The order of the Court of Appeals denying PaineWebber's petition for rehearing and suggestion of rehearing *en banc* is not reported and is set forth in the Appendix as Exhibit B. The order staying the mandate of the Court of Appeals is not reported and is set forth in the Appendix as Exhibit C.

The opinion of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification (App. Exhibit D) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048 (N.D. Ga. 1986). The District Court's opinion denying respondents' motion for reconsideration, granting respondents' motion to certify the case for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982), and staying the District Court's order denying class certification (App. Exhibit E) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880 (N.D. Ga. July 8, 1986).

The order of the Court of Appeals accepting the appeal pursuant to 28 U.S.C. § 1292(b) (1982) is not reported and is set forth in the Appendix as Exhibit F.

JURISDICTION

The judgment of the Court of Appeals was entered on September 15, 1987. (App. Exhibit A). Rehearing and rehearing *en banc* were denied by order dated October 21, 1987. (App. Exhibit B). The mandate of the Court of Appeals was stayed on November 17, 1987. (Appendix Exhibit C).

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[1] Citations herein to material printed in the Appendix appear as either "Appendix" or "(App. _____)." Such citations are to the Appendix to the Petition filed by PaineWebber on or about November 23, 1987.

Petitioner purports to invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

STATUTES AND RULES INVOLVED

The statutes and rules involved in the case are Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l* (2) (1982); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987); Rule 23 of the Federal Rules of Civil Procedure; and 28 U.S.C. § 1292(b) (1982). (App. Exhibit G).

COUNTERSTATEMENT OF THE CASE

Introduction and Overview

Between January 1, 1981 and February 6, 1984 (the "class period"), PaineWebber disseminated a series of documents to the investing public which failed to disclose numerous adverse facts concerning the then-existing, extremely precarious financial condition of Petro-Lewis Corporation ("Petro-Lewis" or the "Company") and the numerous limited partnerships organized by the Company, facts about which PaineWebber was fully aware. In these public documents, PaineWebber—which underwrote the sale of partnership interests to public investors such as respondents—falsely portrayed the partnerships as entities which had highly valuable and proven oil and gas reserves which would generate income to limited partners for twelve or more years when, as PaineWebber well knew, Petro-Lewis had borrowed heavily to sustain distributions to limited partners and to repurchase limited partnership interests tendered by investors under their redemption options. PaineWebber—who as Petro-Lewis' investment banker also orchestrated public offerings of preferred stock and debt in an attempt to salvage the Company—knew that Petro-Lewis' borrowing practices seriously jeopardized the partnerships' holdings, yet fearing a loss of the Company's lucrative investment banking

business, PaineWebber continued to tout the limited partnerships as being virtually risk free, relatively liquid, and suitable for individual retirement accounts and other conservative investments. Petitioner, whose senior management privately discussed the dangerous financial condition of Petro-Lewis and its partnerships, repeatedly reassured its account executives and other "front line" personnel that PaineWebber's "due diligence" department had conducted detailed, ongoing investigations of the partnerships and stood behind those investments. Little did those individual brokers—and their customers—know that at least one senior PaineWebber official, in 1981, had labeled the Petro-Lewis partnership programs a "Ponzi scheme," and several others had secretly expressed concern that candid disclosure of adverse facts about Petro-Lewis would create a "run on the bank" by limited partners. Knowing that Petro-Lewis' very survival depended on the Company's ability to raise money through sales of new partnership interests, PaineWebber suppressed any and all negative information which might jeopardize those sales, and sold more than $200 million of limited partnership interests during the class period.

General Background

From 1970 through 1983, Petro-Lewis was the nation's largest seller of oil and natural gas "income funds." These programs raised money from investors, who became limited partners, and used the proceeds to purchase producing oil and gas properties. *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048, 1050 (N.D. Ga. 1986) (App. D-2).[2] Petro-Lewis and PaineWebber lured new investors to the Petro-Lewis partnership programs with enticements of stable annual returns of 12% or more earned by previous partnerships, and by the apparent liquidity provided by Petro-Lewis' pledge to repurchase any partnership interest tendered by investors. Petro-Lewis formed a new partnership each month. As soon as

[2] The Petro-Lewis partnerships conducted no drilling operations on the properties. PaineWebber highlighted the elimination of the risks associated with development drilling as one of the unique safety features of Petro-Lewis' programs in the written sales literature which it distributed to public investors.

one monthly partnership "closed," another partnership "opened" for sale to investors. When subscriptions in an entire partnership program were sold out, a new program was immediately offered for subscription. The particular monthly partnership an investor joined was primarily a function of when his or her subscription was accepted and the money invested, not any choice of the investor. The average initial investment by a limited partner was $8,600. *Sanders*, 634 F. Supp. at 1050 (App. D-2).

The partnership programs were primarily income-oriented investments with only modest tax shelter features. Limited partners were paid quarterly distributions which they could either receive in cash or reinvest in new partnerships. Those who chose to reinvest their distributions received partnership interests in later partnerships. Cash distributions to the limited partners began almost immediately after each partnership was formed and were to continue for 10 to 15 years or more until the wells were depleted. Except during unusual periods of temporary cash shortages, funds to pay partnership distributions were supposed to come from profits realized from the sale of oil and gas produced by the partnership properties. *Sanders*, 634 F. Supp. at 1050 (App. D-2).

PaineWebber sold the partnership interests pursuant to Sales Agreements with Petro-Lewis. In the Sales Agreements, PaineWebber (identified as the "Dealer") expressly warranted and represented as follows:

> By accepting this Sales Agreement, each Dealer agrees that all applications will be based and all sales of interests will be made, solely on information contained in the current prospectus. Upon request, Distributor will furnish without charge additional copies of the current prospectus in reasonable quantity.

PaineWebber also represented and warranted that it would use "only the prospectus relating to [the partnership program] as it is then currently effective" in connection with the sale of any Petro-Lewis partnership interest, "and to make no offer of

interests unless such offer is preceded or accompanied by such a current prospectus."

PaineWebber received sales commissions of up to 7% on each partnership interest sold, plus special "sales incentive payments" when its aggregate sales exceeded a particular dollar figure. These commissions far exceeded the commissions it received on transactions involving similar types of securities. *Sanders,* 634 F. Supp. at 1052-53 (App. D-6).

As noted above, crucial to the success of this marketing scheme was the apparent steady flow of cash to the limited partners commencing almost immediately after the formation of the partnerships. Petro-Lewis and PaineWebber touted this "regular, reasonably predictable pattern of distributions" in prospectuses for the partnerships and in other written material distributed to prospective investors. Investors hoping to take advantage of those returns invested over $2 billion in various partnerships established between January 1981 and February 1984. *Sanders,* 634 F. Supp. at 1050-53 (App. D-2 to 8).

Unbeknownst to these investors, however, the impression of financial strength and success created by Petro-Lewis and PaineWebber was wholly unfounded. This impression was designed specifically to attract new investors, and to deter existing partners from exercising their redemption options. The truth was that by at least the beginning of 1981, Petro-Lewis and its partnerships were experiencing serious financial problems.

Petro-Lewis had paid premium prices for the partnership properties and had borrowed heavily from banks to help finance the acquisitions.[3] The funds to repay those loans, like the cash distributions to the partners, were supposed to come from the profits generated by the sale of oil and gas produced by the partnership properties. However, the advent of the world oil glut and attendant collapse of oil and gas prices in the early 1980's, coupled with, among other things, increased

[3] The partnership properties were used as collateral to secure the bank debt.

operating costs and competition from other petroleum investment programs, resulted in a severe reduction in cash flow from the partnership properties. These conditions put Petro-Lewis in a serious cash bind and jeopardized the partnership holdings. Nevertheless, in an effort to perpetuate the false impression of financial strength and to continue paying cash distributions, Petro-Lewis continued to borrow heavily from banks (thereby further encumbering the partnership properties) and shifted funds among the accounts of various affiliated companies. Meanwhile, PaineWebber accelerated its sales efforts with respect to the partnership interests. *See Sanders,* 634 F. Supp. at 1050-53 (App. D-2 to 6).

In 1984, the charade collapsed. Petro-Lewis suspended its partnership syndication operations and sold almost one-third of the oil and gas reserves held by the partnerships in order to achieve a $1 billion reduction in bank debt. Petro-Lewis also cut distributions to limited partners, imposed a cap on redemptions of partnerships, and reduced the prices at which it would repurchase those interests to a fraction of previous levels. Investors who elected to retain their partnership interests now hold, instead, units in a royalty trust, which was created as part of a complicated settlement of a securities class action against Petro-Lewis and its principal officers and directors arising out of their role in the scheme described above. *See In re Petro-Lewis Securities Litigation,* [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,899 (D. Colo. 1984). Even taking into account the proceeds of the *Petro-Lewis* settlement, most members of the class have lost more than half of their original investment. *Sanders,* 634 F. Supp. at 1050, 1052 (App. D-2, 6).

Course Of Proceedings And Disposition In The Courts Below

On February 14, 1985, respondents filed a Class Action Complaint (the "Complaint")[4] against PaineWebber for viola-

[4] The Complaint subsequently was amended in respects not material to the issues raised in the Petition.

tions of the federal securities laws and common law arising out of its participation in the scheme outlined above. The Complaint asserts claims against PaineWebber under Sections 11 and 12(2) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k and 77*l* (2), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1987), and for common law fraud, fraudulent concealment, negligence and breach of fiduciary duty. The thrust of the Complaint is that PaineWebber violated these statutory and common law provisions: 1) by disseminating virtually identical prospectuses for the partnership programs during the class period which omitted materially adverse information concerning Petro-Lewis and its partnerships; and 2) by perpetrating a scheme and common course of conduct at the highest levels of PaineWebber's corporate management which had the purpose and effect of suppressing the truth about the precarious financial condition of Petro-Lewis and its partnership programs. *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 721 (11th Cir. 1987) (App. A-5).

Among the material information which respondents contend was omitted from the prospectuses was the following:

1. That the partnership properties were overleveraged;

2. That Petro-Lewis had engaged in a protracted pattern of bolstering cash distributions to previous partnerships by paying those distributions not from cash from operations but, rather, with borrowed funds;

3. That distributions were being inflated in order to ensure that sales in new partnerships continued;

4. That declines in the price of oil would make it impossible to adequately service the partnerships' debt and would result in forced liquidation of the partnership holdings, rendering the investments little more than a rank gamble on the price of oil;

5. That Petro-Lewis utilized improper or highly questionable accounting practices and policies; and

6. That the repurchase prices which Petro-Lewis would pay to limited partners who tendered their interests under the redemption options were extremely volatile, and that Petro-Lewis lacked sufficient funds to handle redemptions, which were coming at steadily increasing rates.[5]

The conspiracy and common course of conduct about which respondents complain is alleged to have been perpetrated at the highest levels of PaineWebber's corporate management. Respondents do not complain of, nor have they ever asserted any claim based upon, any oral statements made to them or any other class member by any individual PaineWebber broker. *Kirkpatrick*, 827 F.2d at 721, 724 (App. A-5, 10 to 11). *See also Sanders*, 634 F. Supp. at 1053-54 (App. D-6 to 9).

The hearing on respondents' motion for class certification took place on February 27, 1986 following briefing and discovery.[6] In its papers opposing the motion, PaineWebber consistently mischaracterized respondents' case to the District Court, arguing that it was one based solely on "oral misrepresentations." This self-serving characterization was reached only by totally ignoring respondents' Complaint in this case, and through a gross distortion of the record which had been developed on the class issue.

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[5] Significantly, seven months after respondents filed their original Complaint in this action, the Securities and Exchange Commission ("SEC") filed a complaint against Petro-Lewis and others for alleged violations of the federal securities laws. In that action, the SEC charged that the prospectuses for the Petro-Lewis partnership programs contained the same material omissions and nondisclosures as those alleged in the Complaint in this action.

[6] With the exception of filing transcripts of respondents' depositions, PaineWebber offered no evidence at the hearing in opposition to the class motion. Rather, petitioner's entire presentation consisted of the legal arguments of its counsel. PaineWebber, which requested the opportunity to present evidence at the hearing in the first place, has overstated both the nature and importance of the "evidentiary hearing".

Respondents made detailed written submissions to the District Court on the class motion prior to the hearing. This included, in addition to extensive briefs, numerous items of documentary evidence and other factual material. The record also consists of documents filed with the District Court in connection with PaineWebber's earlier (and largely unsuccessful) dismissal motions.

In an order dated March 27, 1986, the District Court denied respondents' motion for class certification. The District Court refused to give separate consideration to class treatment of respondents' Securities Act claims. Indeed, the District Court subsequently would rule that it could ignore those claims in their entirety. *Sanders v. Robinson Humphrey/American Express, Inc.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880 at 94,269 (N.D. Ga. 1986) (App. E-3).

Turning to respondents' Exchange Act claims, the District Court specifically found that the case "clearly" satisfied the "commonality" requirement of Rule 23(a)(2) of the Federal Rules of Civil Procedure, because all members of the class shared the following numerous common legal and factual issues:

> (1) whether the prospectuses and other sales literature distributed by the defendants to the plaintiffs and the class contain material misrepresentations of fact or omit material facts concerning the safety and investment worth of the Petro-Lewis partnerships; (2) whether, during the class period, the defendants concealed material information about the precarious financial condition of Petro-Lewis and its partnerships; (3) whether the defendants concealed the truth about the historical performance of the Petro-Lewis partnerships; (4) whether the defendants misrepresented the future business prospects of Petro-Lewis and its partnerships programs; and (5) whether the defendants violated the federal securities laws and the common law in connection with their sales of limited partnership interests in the Petro-Lewis programs during the class period.

Sanders, 634 F. Supp. at 1056 (App. D-13). Similarly, the District Court found that the "typicality" requirement of Rule 23(a)(3) was easily satisfied in the case in light of the allegations that PaineWebber had engaged in a common course

of conduct which affected each member of the class in the same manner:

> The complaints allege that the defendant committed the same unlawful acts by the same method against an entire class. All members of the class, therefore, may have similar claims. Thus, the plaintiffs have met the typicality requirement. Even though class members purchased different Petro-Lewis limited partnership interests, the plaintiffs allege that the defendants engaged in a uniformly fraudulent course of conduct, disseminated virtually identical false prospectuses, financial statements, and other financial information, and failed to disclose material information regarding the operations of Petro-Lewis to purchasers during the class period. *When plaintiffs have alleged such a common course of conduct, courts consistently have found no bar to class certification* . . . .

Sanders, 634 F. Supp. at 1057 (App. D-15) (emphasis added).

When it reached the "predominance" element of Rule 23(b)(3), however, the District Court took an entirely different view of the case. In a totally inexplicable reversal of position, and disregarding its own findings on "commonality" and "typicality," the District Court inconsistently ruled that respondents' Section 10(b) and Rule 10b-5 claims were grounded solely upon "oral misrepresentations" between members of the class and their individual brokers—a formulation of the case which respondents' had neither pleaded nor intend to prove. The District Court adopted that characterization despite the absence from the Complaint of any allegation that respondents' claims were grounded on any such oral statements. In this connection, the District Court declared that it was not even obligated to "look at," let alone accept as true, the allegations of the Complaint for purposes of ruling on the "predominance" issue. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,271 (App. E-10).[7] Having thus recast the case, the District Court

[7] Respondents simply are unable to reconcile this statement with the District Court's discussion of the "commonality" and "typicality" elements of Rule 23, which involved a proper summary of respondents' claims in this case.

ruled that class certification of the Section 10(b) and Rule 10b-5 claims would be appropriate only if respondents were able to demonstrate that PaineWebber had engaged in a uniform "presentation" or standardized "sales pitch" directed to each and every member of the class. Finding the "evidence" on this issue to be deficient,[8] the District Court refused to grant class action status to respondents' Exchange Act claims. *Sanders*, 634 F. Supp. at 1061-63 (App. D-23 to 27).

The District Court, in a position which has been soundly rejected by virtually every court which has addressed the issue,[9] also ruled that the mere possibility that each member of the class might have to prove his or her individual reliance constituted a *per se* bar to class certification. *Sanders*, 634 F. Supp. at 1061, 1063 (App. D-23, 27). The District Court, therefore, focused its inquiry on whether reliance may be presumed under the "fraud on the market" theory adopted in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983). Ignoring numerous paragraphs of respondents' Complaint which contain this *precise* allegation, the District Court held that respondents "*do not allege* that the securities would not have been sold had the misrepresentations not been present"—a necessary predicate to the *Shores* presumption. *Sanders*, 634 F. Supp. at 1063 (App. D-28) (emphasis added). Based on this and its other findings, the District Court denied class certification.

Respondents filed a timely motion for reconsideration which, in an order dated July 8, 1986, the District Court also denied. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,267 (App. Exhibit E). As they had done previously, respondents pointed out, in their motion for reconsideration, that they had, indeed, clearly and unambiguously alleged in their Complaint that "but for" the presence of the misrepresentations and omissions the partnership interests could not have been sold. Apparently mindful of its previous erroneous ruling on this

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[8] This is hardly surprising. Since respondents were not basing their claims on any such oral misrepresentations, it was unnecessary to offer any evidence of any standardized "sales pitch" at the class certification hearing.

[9] *See* note 12 *infra* and accompanying text.

issue, the District Court, in its July 8th order, shifted its analysis to an evaluation of the "support" for that allegation. Paying mere lip service to *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), the District Court conducted a selective analysis of what it considered to be the "evidence" for that allegation and determined that it was insufficient to support the theory. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,271-72 (App. E-9 to 11). However, the District Court specifically found that the issue of class certification involved several controlling questions of law about which substantial grounds existed for differences of opinion and that an immediate appeal from its two orders would materially advance the ultimate termination of the litigation. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 92,274-75 (App. E-17 to 19). Accordingly, the District Court certified the class issue for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982). The Eleventh Circuit Court of Appeals accepted the appeal in an order dated August 21, 1986 (App. Exhibit F).

In a unanimous opinion, the Court of Appeals reversed the denial of class certification with respect to respondents' federal securities law claims. The Court of Appeals ruled that the District Court had erred in refusing to give any consideration whatsoever to possible class treatment of respondents' claims under Sections 11 and 12(2) of the Securities Act. *Kirkpatrick*, 827 F.2d at 725-26 (App. A-12 to 13).

Turning to respondents' Section 10(b) and Rule 10b-5 claims, the Court of Appeals observed that the District Court's entire analysis of the "predominance" issue was "based directly on [its] interpretation of the substance of the plaintiffs' claims." *Kirkpatrick*, 827 F.2d at 721 (App. A-4). Accordingly, the Eleventh Circuit reviewed respondents' Complaint to determine whether the District Court had properly construed those claims. The Court of Appeals concluded that the District Court had not. The Eleventh Circuit unanimously held that the District Court had "mischaracterized" the case as one involving "primarily individualized oral representations rather than a common scheme by the defendants toward the plaintiff purchasers." *Kirkpatrick*, 827 F.2d at 722, 725 (App. A-6, 11). Having placed the case in its proper context, the Court of

Appeals carefully reviewed the entire record in the case, and determined that the "predominance" requirement of Rule 23(b)(3) was easily satisfied. *Kirkpatrick*, 827 F.2d at 724 (App. A-10). The Eleventh Circuit, following a long and unbroken line of authority, held that, "[i]n view of the overwhelming number of common factual and legal issues presented by plaintiffs' misrepresentation claims, . . . the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment." *Kirkpatrick*, 827 F.2d at 724-25 (App. A-11). The Eleventh Circuit also held that the case fell squarely within the principles announced in *Shores v. Sklar*, and that respondents were entitled to a presumption of reliance afforded by the "fraud on the market" theory recognized in that case. In so doing, the Court of Appeals ruled that the District Court could not, as it had done, base its findings on class certification "*upon nothing other*" than the District Court's assessment of the likelihood of success on the merits of respondents' claims. *Kirkpatrick*, 827 F.2d at 723 (App. A-7) (emphasis added).

Having corrected the numerous legal and factual errors which plagued the District Court's orders, the Court of Appeals remanded the class issue to the District Court for application of the correct standards. *Kirkpatrick*, 827 F.2d at 720, 728 (App. A-2, 17).[10]

SUMMARY OF ARGUMENT

The issues raised in the Petition present no novel or unique questions of constitutional or statutory interpretation worthy of review by this Court. The decision of the Court of Appeals is firmly rooted in the precedents of this Court, follows a long and unbroken line of authority in the Eleventh Circuit, and is fully consistent with the case law in other Circuits. The alleged "conflict" which PaineWebber strives mightily to create is nonexistent.

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[10] The other broker-dealer defendants in the companion cases to this one also have filed petitions for writs of certiorari to review the Eleventh Circuit's decision. *See Robinson Humphrey/American Express, Inc., et al. v. Sanders*, No 87-835 (petition filed November 23, 1987) and *J. C. Bradford & Co. v. Kirkpatrick, et al.*, No. 87-932 (petition filed December 7, 1987).

REASONS FOR DENYING THE PETITION

I.

THE ISSUES RAISED IN THE PETITION ARE NOT RIPE FOR DETERMINATION WITH RESPECT TO ALL OF THE QUESTIONS PRESENTED FOR REVIEW

As noted above, the Court of Appeals neither granted nor denied class certification. Rather, the Eleventh Circuit remanded the class issue to the District Court for further proceedings consistent with its decision. Thus, the class motion remains undecided. Under these circumstances, it is unnecessary for this Court to exercise its certiorari jurisdiction at this time to render what essentially would be an advisory opinion.

In *Brotherhood of Locomotive Firemen and Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327 (1967), the Court denied a petition for writ of certiorari where the court of appeals had remanded the case to the district court for further proceedings. In *Brotherhood*, the district court had issued a temporary restraining order against a union prohibiting a strike. The union nevertheless went on strike, and the district court entered contempt orders, imposing substantial fines for alleged violations of its restraining order. On appeal, the court of appeals ruled on many of the legal issues presented to it, but remanded the case to the district court to determine whether there had been substantial compliance with the restraining order and, if not, whether any such violation of the order was deliberate and flagrant. *Bangor & Aroostook R.R. Co. v. Brotherhood of Locomotive Firemen and Enginemen*, 380 F.2d 570 (D.C. Cir. 1967). The union sought certiorari to review the adverse rulings made by the court of appeals. This Court, noting that the court of appeals had remanded the case, held the issues were "not yet ripe for review by this Court," and denied the petition, 389 U.S. at 328.

Just as the court of appeals in *Brotherhood* did not make findings on critical issues but, rather, remanded the case to the District Court for further proceedings, so the Eleventh Circuit here did not certify a plaintiff class but, rather, remanded the case to the District Court for further findings. The issues

involved in this case, as in *Brotherhood,* simply are "not yet ripe for review."

There is no particular exigency which would attend the denial of certiorari in this case. PaineWebber will be free to challenge, as part of the normal appellate process after final judgment, any class which the District Court ultimately might certify in this case. In the interim, numerous developments might occur which could significantly alter or entirely moot the issues raised in the Petition. For example, the District Court might certify a class different from the class pleaded in respondents' Complaint. The District Court also may subsequently alter or amend any certification order which it might enter in this case. *See* Fed. R. Civ. P. 23(c)(1) (district court retains authority to alter or amend a class order until a "decision on the merits"). The jury may return a verdict in favor of PaineWebber on the merits of respondents' claims, thereby effectively mooting all of the issues raised in the Petition.[11] The issues simply are entirely too distant and speculative to warrant review at this time.

As the Court held almost a century ago in *American Construction Co. v. Jacksonville, Tampa & Key West Ry. Co.,* 148 U.S. 372 (1893):

> Whether an interlocutory order may be separately reviewed by the appellate court in the progress of the suit, or only after and together with the final decree, is matter of procedure rather than of substantive right; and *many orders made in the progress of a suit become quite unimportant by reason of the final result or of intervening matters.* Clearly, therefore, *this court should not issue a writ of certiorari to review a decree of the circuit court of appeals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause.*

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[11] Indeed, in that event, PaineWebber undoubtedly would argue in favor of maintaining a class so that it could receive the *res judicata* benefit of any such favorable decision on liability.

Id. at 384 (emphasis added). The Court reaffirmed these principles two decades later in *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251 (1916), when it stated:

> [Certiorari] is a jurisdiction to be exercised sparingly, and only in cases of peculiar gravity and general importance, or in order to secure uniformity of decision .... *And except in extraordinary cases, the writ is not issued until final decree* .... The decree that was sought to be reviewed by certiorari at complainant's instance *was not a final one, a fact that of itself alone furnished sufficient ground for the denial of the application....*

Id. at 258 (emphasis added) (citations omitted). *See also* Supreme Court Rule 17.1. Here, review of the class issue should await not just a ruling on the class motion itself, but final judgment in this case.

There is another, equally compelling, reason for denying the Petition. The centerpiece of PaineWebber's argument unquestionably is its frontal assault on the "fraud on the market" theory enunciated in *Shores v. Sklar.* While that theory may have some bearing on some of respondents' claims, it is undisputed that the "fraud on the market" theory is not implicated at all with respect to several of respondents' other claims. For example, as noted above, among the determinations made by the Court of Appeals was its ruling that the District Court abused its discretion by failing to give "separate consideration" to class certification of respondents' claims under Sections 11 and 12(2) of the Securities Act. *See Kirkpatrick*, 827 F.2d at 726 (App. A-12 to 13). The Eleventh Circuit remanded this issue to the District Court for such a determination. That determination, however, concededly does not and will not involve any consideration of the "fraud on the market" theory, since reliance simply is not an issue with respect to those claims. *See, e.g., Shores v. Sklar*, 647 F.2d at 470 n.7; *Sanders v. John Nuveen & Co.*, 619 F.2d 1222, 1225 (7th Cir. 1980); *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1034 (2d Cir. 1979). Similarly, the Court of Appeals ruled that the District Court "improperly found that the plaintiffs' Rule 10b-

5(2) misrepresentation claims were not suited for class treatment." *Kirkpatrick*, 827 F.2d at 724 (App. A-10). In so doing, the Court of Appeals held that "the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment." *Kirkpatrick*, 827 F.2d at 724-25 (App. A-11).[12] Thus, respondents need not rely on the presumption of reliance afforded by the "fraud on the market" theory for class certification of their Rule 10b-5(2) misrepresentation claims. That theory, under the circumstances of this case, is simply inapplicable to those claims.

In summary, the District Court, on remand, must reconsider the issue of class certification irrespective of the outcome of the issues raised in the Petition. Under these circumstances, granting the writ will serve merely to the delay resolution of this case without any concomitant contribution to the preservation of judicial resources. To the contrary, the judicial process will be ill-served by such piecemeal, fragmented litigation.

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[12] This principle has received such widespread and uniform acceptance by the Circuits that it is no longer subject to serious dispute. *See, e.g., Eisenberg v. Gagnon*, 766 F.2d 770, 786 (3d Cir.), *cert. denied*, 106 S.Ct. 342 (1985); *Blackie v. Barrack*, 524 F.2d 891, 902 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). As the Second Circuit observed in *Green*:

> Wolf earnestly argues that each person injured must show that he personally relied on the misrepresentations in order to recover and thus any common issues of misrepresentations do not predominate over the individual questions of reliance. Even if Wolf is correct in its assertion of the need for proof of reliance, and we express no views on that issue, we must still reject the argument. Carried to its logical end, it would negate any attempted class action under Rule 10b-5, since as the District Courts have recognized, reliance is an issue lurking in every 10b-5 action.

406 F.2d at 301. *Accord, In re Home-Stake Production Co. Securities Litigation*, 76 F.R.D. 351, 372 (N.D. Okla. 1977); *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544, 547-48 (E.D. Pa. 1976); *Vernon J. Rockler v. Graphic Enterprises, Inc.*, 52 F.R.D. 335, 345-46 (D. Minn. 1971).

II.

THE DECISION OF THE COURT OF APPEALS IS FIRMLY ROOTED IN WELL-SETTLED PRINCIPLES OF LAW AND PROCEDURE AND IS FULLY CONSISTENT WITH EXISTING PRECEDENT

A. The Court Of Appeals Properly Concluded That The District Court, In Ruling On A Motion For Class Certification, Was Not Permitted To Disregard The Allegations Of Respondents' Complaint And Recharacterize The Case In A Manner Which Respondents Neither Pleaded Nor Intend To Prove

The Court of Appeals—far from according blind deference to respondents' Complaint, as petitioner suggests—merely held that the District Court could not disregard respondents' Complaint in its entirety and unilaterally reformulate respondents' case in a manner which they neither pleaded nor intend to prove. The Eleventh Circuit adopted a view of the case which *the District Court itself* had adopted in analyzing the "commonality" and "typicality" requirements of Rule 23—one grounded on a common course of fraudulent conduct which affected each member of the class in the same manner, and involving widely distributed uniform written material. The Court of Appeals held that the evidence presented both prior to and during the class certification hearing, *viewed in its proper context,* supported certification of the Section 10(b) and Rule 10b-5 claims. The Court of Appeal's decision is legally correct, factually sound, and does not merit review by this Court. One need only read respondents' Complaint (something which the District Court stated it was not required to do) to reach the same conclusion.

PaineWebber has only itself to blame for leading the District Court astray through its persistent mischaracterizations of respondents' case. Such tactics frequently are employed by those who would deny any relief to a class of defrauded investors. Typical is *Shankroff v. Advest, Inc.*, 112 F.R.D. 190 (S.D.N.Y. 1986). *Shankroff* is particularly instructive, for it involves identical claims against another brokerage firm—

Advest, Inc.—which sold the Petro-Lewis partnerships. The court in *Shankroff* granted plaintiff's motion for class certification in that case and (unlike the District Court here), refused to succumb to the arguments of defense counsel that it reformulate plaintiff's case:

> Advest contends that common questions of law or fact neither exist nor predominate. Advest maintains, first, that there is no common nexus between the different Petro-Lewis partnerships, which are described in a number of different prospectuses; and second, that each potential class member's claim is distinct because the alleged frauds are based on oral, not written, representations. Thus, Advest argues, the nonuniformity of the representations characterize the issues as highly individual in nature.
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> *Advest's argument, however, mistakes plaintiff's claim.* The premise of plaintiff's complaint is that Advest, whose business consists of analyzing investment prospects and providing financial advice to its clients, engaged in a "course of conduct" designed to encourage investment in Petro-Lewis limited partnerships while failing to disclose Petro-Lewis' deplorable financial condition. Where the facts as alleged show that defendant's course of conduct concealed material information from an entire putative class, the commonality requirement is met.
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> . . . .
>
> Since plaintiff's allegations focus on overall managerial decisions which affected all Advest clients, questions of oral representations or individual reliance do not overwhelm the issues common to the class.

112 F.R.D. at 193 (citations omitted). To the same effect is *In re Baldwin-United Corp. Litigation*, MDL No. 581, M21-35 (CLB) (S.D.N.Y., June 27, 1986 Memorandum Opinion and Order Granting Class Certification).[13] There, the same defen-

[13] A copy of the decision in *Baldwin-United*, which is unreported, is included in the Appendix hereto ("Res. App.") as Exhibit A.

dant involved in this case—PaineWebber—attempted to defeat class certification by using the same, time-worn argument that the claims in that case were grounded upon oral misrepresentations.[14] The court gave that argument short shrift, and certified the class. (Resp. App. A-4 to 7).

As the Eleventh Circuit specifically found, the focus of this case is on the prospectuses and other written material distributed to members of the class and on the fraudulent conduct of PaineWebber's senior management, *not* on any ancillary oral statements made by individual PaineWebber brokers to their clients.[15] Under such circumstances, courts have uniformly held that mere presence of oral statements will not render individual questions of reliance predominate over the common issues of fraud and materiality. *See, e.g., Kennedy v. Tallant,* 710 F.2d 711, 717-18 (11th Cir. 1983) (presence of oral statements does not defeat certification since "substance of the oral communications . . . is not an issue in the suit."); *Esplin v. Hirschi,* 402 F.2d 94, 97 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969) ("[u]ndoubtedly the possibility exists that there will be questions of individual oral misrepresentations to each of the potential plaintiffs," but "having alleged . . . that there was omissions and half truths common to all purchasers . . . it is apparent that the issue of liability . . . was to be the same as to all purchasers"); *Arthur Young & Co. v. United States District Court,* 549 F.2d 686, 695 (9th Cir.) *cert. denied,* 434 U.S. 829 (1977) (alleged reliance on oral statements was of "questionable evidentiary significance for purposes of making a Rule 23 determination" in case involving primarily written misrepresentations); *Eisenberg v. Gagnon,* 766 F.2d 770, 786 (3d Cir.), *cert. denied,* 106 S.Ct. 342 (1985) (denial of class certification under similar facts was an "abuse of discretion"); *Sharp v. Coopers & Lybrand,* 70 F.R.D. 544, 548 (E.D. Pa.

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[14] The products involved in *Baldwin-United* were annuity-type securities sold to the public through PaineWebber's network of account executives.

[15] The Eleventh Circuit also specifically found that the record in this case was devoid of any evidence that class members were even exposed to differing oral communications, let alone that any such communications "varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes." *Kirkpatrick,* 827 F.2d at 724 (App. A-10). This is uncontroverted.

1976) (presence of oral statements does not defeat certification when claims based on uniform written documents); *Fox v. Prudent Resources Trust,* 69 F.R.D. 74, 82 (E.D. Pa. 1975) (possible variations in oral statements made to limited partners in oil and gas investment programs did not defeat class certification when a fraudulent prospectus was also the basis of plaintiff's claim); *In re Home-Stake Production Co. Securities Litigation,* 76 F.R.D. 351, 369-73 (N.D. Okla. 1977) (same); *Jenson v. Continental Financial Corp.,* 404 F. Supp. 806, 813 (D. Minn. 1975) (same); *Mulcahey v. Petrofunds,* 79 F.R.D. 272, 278-80 (S.D. Tex. 1978) (same).

The *Simon* case, relied upon so heavily by PaineWebber, is so easily distinguishable that it has virtually no precedential value beyond its limited facts. (*See* Petition at 15, *discussing Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc..,* 482 F.2d 880 (5th Cir. 1973)). In *Simon,* the plaintiff purchased the securities entirely on the basis of information provided to him by a corporate insider, and, admittedly, did not rely upon any representations by the defendant broker. Thus, the court quite properly found that the case involved "unique" oral statements which were not common to the class. Here, by contrast, any oral statements were based on standardized written materials and were merely ancillary to those documents, a distinction which the *Simon* court specifically noted would make class treatment appropriate. *Id.* at 882-83.

These courts have adopted a common sense approach, and recognize that it is the rare securities transaction which is not accompanied by some type of oral communication between an investor and his or her broker. Adoption of a *per se* bar to class certification whenever a securities transaction involves oral communications—the very position advocated by PaineWebber and adopted by the District Court here—would totally eviscerate the class action device in the securities context. It is undoubtedly for this reason that the courts have consistently rejected such an approach.

Straining to bring this case within one of the categories of Supreme Court Rule 17, PaineWebber, grasping for straws, argues that there is a "direct conflict" between the Eleventh and

Fifth Circuits over the issue of class certification of claims arising under Section 10(b) and Rule 10b-5. (Petition at 14-16). PaineWebber contends that class treatment of such claims is appropriate only if plaintiffs are able to demonstrate a "uniform sales pitch" or other standardized presentation to the class. This argument, of course, is a replay of the same false premise which PaineWebber urged on the District Court and which the Eleventh Circuit expressly rejected—*i.e.,* that respondents' claims in this case are grounded on "oral misrepresentations". In this connection, PaineWebber apparently refuses to recognize the difference between "oral representations" and "oral *mis*representations." The former may be entirely consistent with the written materials and their mere presence in a case, as the Eleventh Circuit found here and as the cases cited previously uniformly hold, will not defeat certification. Oral *mis*representations, by contrast, may give rise to liability under the federal securities laws, and present a problematic situation for class certification, *if—but only if—the class' claims are grounded on those oral misstatements.* In those types of cases, the plaintiff must come forward with evidence of a standardized sales pitch in order to satisfy the requisite "commonality" and "predominance" elements of Rule 23. That is not *this* case. There is no conflict.

B. The Court Of Appeals Did Not Ignore The Evidence At The Class Hearing But, Rather, Viewed The Entire Record In Its Proper Context

PaineWebber argues that the Court of Appeals disregarded the evidence presented at the class hearing and based its decision on the class issue solely on "the four corners of the [C]omplaint." (Petition at 12). An examination of the Eleventh Circuit's decision belies this contention.

The Eleventh Circuit was mindful of the necessity, in particular cases, of looking beyond the face of pleadings in connection with the class action determination to see whether the requirements of Rule 23 have been satisfied. The Eleventh

Circuit's position on this issue—fully consistent with the precedents of this Court—could not be more clear:

> Certainly, as the [District Court] noted in its order, a court may look beyond the allegations of the complaint in determining whether a motion for class certification should be granted.

Kirkpatrick, 827 F.2d at 722 (App. A-7), *citing General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147 (1982). Indeed, the Eleventh Circuit specifically recognized that such inquiries—such as depositions of the named plaintiffs—routinely are employed in connection with the "adequacy" and "typicality" determinations of Rule 23(a). *Kirkpatrick*, 827 F.2d at 723 (App. A-7).

Here, the decision of the Court of Appeals, on its face, reveals careful consideration of the entire record in this case, including the evidence offered at the class hearing. The Eleventh Circuit simply viewed the record differently than did the District Court, a view which gave proper recognition to the claims as pleaded by respondents, not as unilaterally reformulated by the court below at the behest of PaineWebber. In this connection, the following observation in *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 US. 816 (1976) is instructive:

> [T]he district judge is necessarily bound to some degree of speculation by the uncertain state of the record on which he must rule. An extensive evidentiary showing of the sort requested by defendants is not required. So long as he has sufficient material before him to determine the nature of the allegations, and rule on compliance with the rule's requirements, and he bases his ruling on that material, his approach cannot be faulted because plaintiffs' proof may fail at trial. *Of course, whether he applied correct legal principles in making the ruling, and whether the ruling was within the permissible boundaries of the discretion vested in him, is another question . . . .*

Id. at 901 (emphasis added).

Furthermore, as the Eleventh Circuit specifically found, the District Court—far from conducting a simple inquiry into the merits to assist it in understanding the class issues—instead evaluated the evidence and based its class determination "*upon nothing other* than the [District Court]'s assessment of the plaintiffs' likelihood of success on the claims." *Kirkpatrick*, 827 F.2 at 723. (App. A-7) (emphasis added). In essence, the District Court, at the class certification stage, demanded not merely factual support for respondents' claims but virtually conclusive evidence of petitioner's guilt. The Eleventh Circuit properly held that such a weighing of the evidence constituted an impermissible intrusion into the merits.[16]

In any event, even if the Court of Appeals, as PaineWebber complains, took a "deferential view" of respondents' Complaint (Petition at 5), such an approach would have been entirely consistent with the cases which hold that the substantive allegations of the complaint must be accepted as true for purposes of ruling on a class motion. *See, e.g., Blackie v. Barrack*, 524 F.2d at 901 & n.17; *Miller v. Mackey Int'l Inc.*, 452 F.2d 424, 427-28 (5th Cir. 1971); *Green v. Wolf Corp.*, 406 F.2d 291, 294 n.1 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). The correct rule was summarized in *Westlake v. Abrams*, 565 F. Supp. 1330, 1337 (N.D. Ga. 1983), where the court stated:

> [T]here is absolutely *no support* in the history of Rule 23 or legal precedent for turning a motion under Rule 23 into a Rule 12 motion to dismiss or a Rule 56 motion for summary judgment *by allowing the district judge to evaluate the possible merits of the plaintiff's claims at this stage of the proceedings.*

Id. (emphasis added) (citations omitted). *See also Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974) (district court is not "to conduct a preliminary inquiry into the merits of a suit to determine whether it may be maintained as a class action");

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[16] Such an approach, if permitted, also would fly squarely in the face of Rule 23 (c)(1), which requires that the class determination be made "as soon as practicable after the commencement of an action brought as a class action. . . ." Fed. R. Civ. P. 23(c)(1).

Seidman v. Stauffer Chemical Corp., [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,868 at 94,228 (D. Conn. 1986) (allegation of common scheme or plan to defraud sufficient for ruling on class motion: "It was not necessary to establish its existence.").

C. The Decision Of The Court Of Appeals Falls Squarely Within The Holding Of *Shores v. Sklar* And The Unbroken Line Of Authority Which Has Followed In Its Wake

The Court of Appeals correctly held, as has every other court which addressed the issue,[17] that a plaintiff alleging fraud under Rule 10b-5 may, in circumstances where it is alleged that securities could not have been marketed "but for" the fraud, invoke a rebuttable presumption of reliance upon the integrity of the marketplace. *Kirkpatrick*, 827 F.2d at 722-23 (App. A-6 to 7), *citing Shores v. Sklar, supra.*[18]

Reliance is generally part of the logical chain needed to establish that a defendant's misrepresentation or omission in fact caused the plaintiff's injury. *See List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). Although the requirement is easily met by showing the plaintiff's actual subjective reliance on the defendant's misstatement (*see* 3 L. Loss, *Securities Regulation*, at 1430-32 (2d ed. 1961)), courts have held that proof of such direct reliance is not necessary in certain cases, including those alleging a *Shores*-type "fraud on the market."

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[17] *See, e.g., T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Shores v. Sklar, supra; Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977); *Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F. Supp. 1180, 1201-03 (W.D. Mo. 1983); *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730, 735-37 (W.D. Va. 1982); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406, 410-11 (W.D. Mo. 1982). *See also* Note, *Fraud On the Market—An Emerging Theory Of Recovery Under SEC Rule 10b-5*, 50 Geo. Wash. L. Rev. 627, 645-55 (1982).

[18] The Eleventh Circuit, in the *en banc* decision *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981), adopted as precedent the decisions of the former Fifth Circuit, including *Shores*, rendered prior to October 1, 1981.

The "fraud on the market" theory recognized in *Shores* (and reaffirmed by the Eleventh Circuit here) is grounded on the premise that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the marketplace." *Shores*, 647 F.2d at 471. Under *Shores*, the requisite causation is provided by proof that "securities not traded on the open market could not have been issued but for a fraudulent scheme by the defendants." *Kirkpatrick*, 827 F.2d at 722 (App. A-7), *citing Shores*, 647 F.2d at 469. Allegations to that effect allow a rebuttable presumption that investors who purchased the securities and relied on the integrity of the market were harmed by the defendant's fraud.

The logic underlying the theory is manifest. If securities could not have been marketed but for a fraudulent scheme, it follows that an investor satisfies the requisite causal link by evidence that he or she purchased the securities in reliance, in whole or in part, on the integrity of the market. Indeed, as the Eleventh Circuit noted here, recognition of the "fraud on the market" theory is as compelling in a *Shores*-type case as it is in a so-called "open market" [19] context. *Kirkpatrick*, 827 F.2d at 718 (App. A-9) (footnote omitted).

There is no conflict on this issue in the lower courts. And the Eleventh Circuit's holding in this case is not, as petitioner suggests, a departure from any of those cases. To the contrary, it falls squarely within the holding of *Shores*. Even the so-called "critics" of the theory (*see* Petition at 9) concede its applicability, as the Eleventh Circuit applied it here, to claims

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[19] *See Basic Inc. v. Levinson*, 107 S.Ct. 1284 (1987), *granting cert. to*, 786 F.2d 741 (6th Cir. 1986). *See also Peil v. Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Harris v. Union Electric Co.*, 787 F.2d 355, 367 & n.9 (8th Cir. 1986), *cert. denied*, No. 85-2036 (Oct. 6, 1986); *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 132 (1985); *T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *vacated as moot after cert. granted*, 459 U.S. 1027 (1982); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

under subsections (1) and (3) of Rule 10b-5. *See* Note, *The Fraud On The Market Theory*, 95 Harv. L. Rev. 1143, 1157-58 n.56 (1982). Respondents clearly alleged that the Petro-Lewis securities could not have been marketed "but for" the fraudulent scheme, and respondents came forward with uncontroverted evidence that they relied on the integrity of the market when they made their purchases. No more is required at the class certification stage.

Nor is certiorari warranted, as petitioner contends (Petition at 10, 14), to limit the potential abuse of class actions. Contrary to petitioner's assertion, the presumption of reliance in a "fraud on the market" case is grounded in characteristics of securities markets and investor behavior that are present in both class actions and individual actions. The presumption is not applied to facilitate class status in cases that would not otherwise be amenable to prosecution as class actions. *Shores* did not open the floodgates to class action litigation in securities cases, and the strict application of *Shores* by the Eleventh Circuit here likewise will have no such effect. The speculative horrors imagined by PaineWebber are contrived.

Furthermore, the presumptions underlying the "fraud on the market" theory promote important policies under the federal securities laws. The federal securities laws were adopted in large measure to restore integrity to, and investor confidence in, the securities markets.[20] A fundamental premise of the Exchange Act is that, since the markets are affected by information, "[t]here cannot be honest markets without honest [information]." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 11 (1934). An equally fundamental premise is that investors rely on the integrity of the markets. A defendant in a case brought under the federal securities laws who contends that these fundamental premises are not true in a particular case should bear the burden of proving it.

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[20] This Court has "repeatedly emphasized that implied private actions [under Rule 10b-5] provide a most effective weapon in the enforcement 'of the securities laws and are a necessary supplement to Commission action.'" *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985), *quoting J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).

D. The Court Of Appeals Did Not Establish An Irrebutable Presumption Of Reliance In *Shores*-type "Fraud On the Market" Cases

Contrary to PaineWebber's argument, the Eleventh Circuit did not create a broad rule of general applicability which establishes an irrebuttable presumption of reliance in *Shores*-type "fraud on the market" cases. Nor did the Court of Appeals lay down any such rule in this particular case. PaineWebber is free to rebut the presumption by establishing that no fraud occurred; that even if the offerings were tainted with fraud, full disclosure of the true facts nevertheless would not have prevented the securities from being marketed at *some* price (albeit lower than they were); or that respondents did not rely at all on the integrity of the market. *Shores*, 647 F.2d at 470.

III.

THE DISTRICT COURT AND THE COURT OF APPEALS PROPERLY EXERCISED THEIR DISCRETION UNDER 28 U.S.C. § 1292(b) IN CERTIFYING AND ACCEPTING, RESPECTIVELY, THE CLASS ISSUE FOR INTERLOCUTORY REVIEW AND, IN ANY EVENT, THIS ISSUE HAS BEEN RENDERED MOOT BY THE ISSUANCE OF THE CIRCUIT COURT'S DECISION ON THE MERITS OF THE APPEAL

PaineWebber's criticism of the propriety of the District Court's certifying, and the Eleventh Circuit's accepting, interlocutory review of the class certification order hardly merits serious discussion. In the wake of the denial of class certification, several members of the putative class filed individual protective actions against PaineWebber asserting claims similar to those asserted in the class case.[21] The District Court specifically found that "[r]esolving the class certification on interlocutory appeal will prevent any duplicative effort" on the part of the parties to the various cases and would conserve judicial resources. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at

[21] Those actions have been stayed pending resolution of the class motion in this case.

94,274-75 (App. E-17 to 19). The District Court also was mindful of the rights of members of the class, many of whom are counting on the class action to vindicate their rights, but most of whom lack sufficient funds or incurred sufficient losses to justify pursuing their claims on an individual basis. *(Id.)* These were uniquely discretionary rulings by the District Court, accepted by the Court of Appeals, which should not be reviewed by this Court. Indeed, this entire issue was rendered moot when the Eleventh Circuit rendered its decision on the merits of the appeal.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari to review the decision of the United States Court of Appeals for the Eleventh Circuit should be denied.

Dated: Haverford, Pennsylvania
December 23, 1987

Respectfully submitted,

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APPENDIX A

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

MDL 581-IN RE BALDWIN-UNITED CORPORATION LITIGATION — M 21-35 (CLB)

MEMORANDUM DECISION
[Class Certification]

This Document Relates To:

ALFRED LINTON and JEROME W. EICHELSBACHER,
Plaintiffs,

-against-

SHEARSON LEHMAN/AMERICAN EXPRESS, INC., *et al.*,
Defendants.

83 Civ. 8476 (CLB)

VINCENT ERTI, *et al.*,
Plaintiffs,

-against-

PAINEWEBBER JACKSON & CURTIS, INC., *et al.*,
Defendants.

83 Civ. 9085 (CLB)

(caption continues)

(caption continued)

OSCAR J. WOODS, *Plaintiff,* -against- W.H. NEWBOLD'S SONS & CO., INC., *et al.* *Defendants.*	84 Civ. 2235 (CLB)
STEVEN A. PEREL, *Plaintiff,* -against- ROTAN MOSLE, INC., *et al.*, *Defendants.*	84 Civ. 8879 (CLB)

Brieant, J.

By motion fully argued and submitted on March 7, 1986, plaintiffs in this multidistrict litigation seek class certification pursuant to Rule 23, F.R.Civ.P., in each of the above-captioned four actions, which have been consolidated in this Court by transfer orders on the Judicial Panel on Multidistrict Litigation. Familiarity of the reader with all prior proceedings in this litigation is assumed, although the Court directs special attention to its decision *In Re Baldwin-United Corp.*, 105 F.R.D. 475 (S.D.N.Y. 1984), in which the Court certified tentative classes in fourteen related cases against different defendants on similar claims, for the purpose of settlement. Subsequently, a total of twenty-four consolidated class actions against that many broker-dealer defendants in the Baldwin-United securities litigation were certified and each was settled.

Plaintiffs in these four remaining actions allege that the defendant broker-dealers and Planco, Inc. engaged in a common course of fraudulent conduct in omitting material information in connection with their sales of certain investment contracts to the plaintiffs. These contracts, known as single

premium deferred annuities (SPDAs), were issued from 1979 to 1983 by two insurance subsidiaries of Baldwin-United and were marketed to the public nationwide by various means, including sale through broker-dealers such as the defendants in these four actions. In 1983, the two issuing insurance companies and four other subsidiaries that reinsured the SPDAs were placed in rehabilitation, and the parent corporation, Baldwin-United, entered bankruptcy. Thereafter, SPDA purchasers, including the class plaintiffs herein, commenced the federal civil actions that eventually were consolidated into this multidistrict litigation.

Jurisdiction is conferred over the federal law claims by Section 22 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77(v), Section 27 of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78aa, and Section 4 of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1964. The Court is likewise empowered to hear the state statutory and common law claims pleaded by virtue of diversity of citizenship and under principles of pendent jurisdiction.

The amended consolidated complaints in the *Linton, Erti* and *Woods* actions and the complaint in *Perel* each recite nine separately denominated claims for relief alleging violations of Sections 5, 12(1) of the Act, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, and Section 1962(c) of RICO, as well as common law fraud and deceit and violations of state securities, consumer and fiduciary responsibility laws. The plaintiffs also assert claims premised on common law negligence, breach of contract and breach of fiduciary duty against all defendants except Planco, Inc. ("Planco"). Except for variations in the pleadings to account for facts peculiar to each plaintiff, the complaints are identical in all respects pertinent to these class certification motions. Therefore, the Court will not distinguish among them when examining their suitability for class certification, except as may be required to consider specific, fact-oriented arguments raised by a particular broker-dealer that call for individualized analysis.

Numerosity

In order to qualify for class action treatment, plaintiff must demonstrate that each of the four prerequisites set forth in Rule 23(a) has been satisfied and, in addition, that at least one of the factors described in Rule 23(b) is present. The first requirement, that the classes be so numerous that joinder of all the aggrieved individuals would be impracticable, is not contested here. Over several years, each broker-dealer sold SPDAs having an aggregate face value well in excess of a million dollars to purchasers throughout the country. The identity and exact number of prospective class members are ascertainable from defendants' records and those of the state rehabilitators of the issuers, and it is reasonable to conclude in view of the magnitude of this marketing effort that the number of affected persons would justify class certification.

Commonality

The second requirement, commonality, is more problematic. Under Rule 23(a)(2), plaintiffs must show that common questions of law and fact susceptible to class treatment predominate among the putative class members' claims. The gravamen of plaintiffs' complaints is that the defendants, in connection with their business of analyzing investment opportunities and providing financial services to clients, each engaged in a similar unified course of conduct to promote and sell Baldwin-United's SPDAs to the public without disclosing that the issuer was experiencing financial and regulatory difficulties. Plaintiffs contend that the defendants, at the corporate, policy making level, knew or recklessly disregarded evidence of Baldwin-United's precarious financial condition and that they elected to implement or maintain standardized marketing practices that concealed the true investment risks of the SPDAs. Those practices, plaintiffs allege, emphasized the safety, liquidity and promising investment aspects of the SPDAs even though information available to the defendants foretold Baldwin-United's collapse. Plaintiffs contend that the defendants' failure to investigate and ascertain the solidity of the SPDAs' financial backing, their practice of using uniformly deceptive promotional materials to solicit purchases, and their

failure or refusal to disclose the material omissions and half-truths embodied in their marketing strategy together caused SPDA holders to sustain substantial injury when their investments deteriorated.

The broker-dealers, for their part, deny that common issues of law and fact predominate. They maintain that the core issues submitted by plaintiffs in their complaints turn largely on oral rather than written representations, or on non-uniform documents that will require greater investigation and analysis of individual facts than class treatment will allow. For example, defendants assert, the threshold issue—whether the SPDAs are in fact securities—invites inquiry into the manner in which the SPDAs were sold and how they were described to prospective investors. Similarly, allegations of statutory and common law fraud would require the Court to make findings as to the parties' state of mind, the information disclosed, and also the fluctuating fortunes of Baldwin as of the time a particular investor made his or her purchase. The defendants therefore conclude that the highly individualized character of these transactions, affecting some 50,000 investors, makes class certification inappropriate.

This Court disagrees. The nub of plaintiffs' claims is that material information was withheld from the entire putative class in each action, either by written or oral communication. Essentially, this is a course of conduct case, which as pled satisfies the commonality requirement of Rule 23, F,R.Civ.P. *See, Green* v. *Wolf Corp.*, 406 F.2d 291, 300 (2d Cir. 1968), *cert. denied,* 395 U.S. 977 (1969). Although their circumstances may vary slightly, the class members are united in attempting to establish the defendants' liability for fraudulently creating an illusion of profitability and a false sense of security when the undisclosed facts suggest otherwise. The fact that the Planco marketing brochures may have varied slightly from broker to broker and customer to customer is not controlling here. Plaintiffs allege not that the promotional materials themselves were uniform, but rather that the information they contained—and hence that the broker-dealers disseminated—was uniformiy misleading. Thus, at the very outset, the common issue of fact uniting all SPDA purchasers is

whether the Planco sales literature to which they were exposed was distorted by identical half-truths and omissions that materially affected their investment decisions. Following closely are common questions of the broker-dealers' own culpability in utilizing these materials and in failing to detect and disclose information that would have revealed the SPDAs' shaky foundations. Liability in this case does not depend on proof of the individual, face-to-face dealings between the class members and the registered representatives of the broker-dealers, and slight differences in the class members' positions will not defeat their common status as alleged victims of similar misrepresentations. *See Blackie* v. *Barrack,* 524 F.2d 801, 902 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976). The wrongful conduct alleged by plaintiffs occurred at the management level, if it did, and manifested itself in the defendants' course of promoting and selling the SPDAs. As a result, the relevant questions are readily susceptible to class-wide proof.

Indeed, inquiries into the actual sales process are of secondary importance. Plaintiffs are not required to establish how each and every SPDA was sold in order to prove that the SPDAs were securities. Similarly, it is not fatal to class certification that a particular investor did not receive or rely upon the contents of a Planco brochure. In a case such as this where liability would rest primarily on a failure to disclose material facts, positive proof of reliance is not a prerequisite to recovery. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 153-54 (1972). Similarly, the presence of oral representations or embellishments proffered by an account representative will not rend this class, even if they were the sole basis for an individual's decision to purchase an SPDA. Unlike *In Re Scientific Control Corp. Securities Ltd.,* 71 F.R.D. 491 (S.D.N.Y. 1979), and other cases where claims based on oral representations were denied class status, in this case the representations related to objective factors—the issuer's financial stability or the safety, yield and liquidity of the SPDAs—that originated from a common source: the Planco documents or the broker-dealers' alleged refusal to conduct their own investigations. *See Korn* v. *Franchard Corporation,* 456 F.2d 1206, 1212 (2d Cir. 1972). Even proof of a material variance

among the representations will not defeat the class if certain omissions, inferred from their absence in the Planco literature, were common to all. *See Esplin* v. *Hirschi,* 402 F.2d 94, 99-100 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969).

The defendants also argue that individual questions relating to the timeliness of certain securities claims predominate over any common issues that may exist. The Court disagrees. Camouflaged as an attack on commonality, this argument in fact invites the Court to examine and accept in the course of these class certification motions an affirmative defense that is potentially dispositive of several claims in this litigation. Such inquiry is outside the scope of Rule 23 and indeed defies the principle enunciated in *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974), that a court may not review the substantive issues raised in a class complaint when determining the claims' suitability for class treatment. *See, e.g., Chevalier* v. *Baird Savings Association,* 72 F.R.D. 140, 150 (E.D. Pa. 1976); *see also Mersay* v. *First Republic Corporation of America,* 43 F.R.D. 465, 471 (S.D.N.Y. 1968) (class certified notwithstanding individual questions as to statute of limitations).

Accordingly, the Court concludes that common issues of fact predominate in these actions and that the requirements of Rule 23(a)(2) have been satisfied.

Typicality

The third prerequisite for maintaining a class action under Rule 23 is that the individual claims advanced by the named plaintiffs are sufficiently typical of those asserted by the class members they purport to represent. Rule 23(a)(3), F.R.Civ.P. As a general rule, a plaintiff's claim meets the typicality requirement if it arises from the same events or course of conduct that gives rise to the claims of other class members and if it is based on evidence and legal theories consistent with the other members' claims. *Dura-Bilt Corporation* v. *Chase Manhattan Corp.,* 89 F.R.D. 87, 99 (S.D.N.Y. 1981). The test, ultimately, is whether the class representative will promote the interests of the class as he protects his own.

Because this inquiry focuses on the nature of the claims asserted, factual differences involving the date, type and manner of the purchase, the investor's perception of the transaction, or even the information furnished to him at the time will not destroy typicality if each class member was the victim of the same material omissions and the same consistent course of conduct. *See Dura-Bilt, supra; Oscar Gruss & Son* v. *Geon Industries, Inc.*, 75 F.R.D. 531, 534-35 (S.D.N.Y. 1977). This is so even though, as the defendants claim, the amount and type of information available to the public changed constantly throughout the class period, and the named plaintiffs supposedly had purchased their SPDAs at a time when Baldwin-United enjoyed good financial health. The lynchpin of plaintiffs' claim is the alleged nondisclosure of material facts relating to Baldwin-United's solvency; whether the named plaintiffs can prove an actionable omission to sustain their claims invites comment on the merits, which is forbidden in the context of this class certification motion. *See Eisen*, 417 U.S. at 178. Moreover, this Court finds that the putative class representatives will have a strong incentive to develop evidence pertaining to the entire class period because their claims rely on proof of a consistent course of conduct that extended beyond the instances of alleged fraud unique to them.

Similarly, the presence of common law issues in these complaints does not destroy typicality, even though the named plaintiffs will be called upon to represent individuals of many different states if a class is certified. Common law fraud substantially includes the 10b-5 claims, and the Court can order separate hearings to resolve the question of damages, if the need arises.

Notwithstanding certain variations in proof among members of the prospective class, the Court finds that the plaintiffs have satisfied the typicality requirement by showing that the same allegedly unlawful conduct affected all members of the prospective class.

Adequacy of Representation

Finally, before certifying the named plaintiffs as class representatives, the Court must be convinced that they will fairly and adequately protect the interests of the absent class members. Rule 23(a)(4), F.R.Civ.P. Although it is not necessary that the putative representatives' claims are identical to those of the class, the constraints of due process preclude class certification if the named plaintiffs possess other, potentially conflicting interests that would impair the vigorous prosecution of the class claims. *See Hansberry* v. *Lee*, 311 U.S. 32 (1940). As set forth above, factual differences involving the sales transaction, for example, the type of promotional material used by the various account representatives and the extent to which the purchaser relied on it, will not defeat class certification. Similarly unpersuasive is the argument, also proffered above, that the plaintiffs who purchased their SPDAs early in the class period have no incentive to prove facts relevant to a purported fraud committed on a subsequent purchaser. Nor can there by any question as to the qualifications, industry and commitment of plaintiffs' counsel. All class members stand or fall on the issue whether material information was misrepresented or withheld from SPDA purchasers, and the Court believes that the named plaintiffs will pursue this issue vigorously.

The Court therefore concludes that each of the prerequisites of Rule 23(a) is satisfied. In addition, the Court finds pursuant to Rule 23(b)(3) that questions of law and fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is the superior method of adjudicating this controversy fairly and adequately.

Shearson Lehman argues that arbitration, which is available upon request to each putative class plaintiff in the Shearson Lehman track of cases, is a less expensive, more efficient—and hence superior—alternative to class litigation on certain arbitrable securities claims. Even assuming for the argument that our Court of Appeals' decision in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94, 96 (2d Cir. 1986), was

wrong, *cf. Dean Witter Reynolds, Inc.* v. *Byrd*, ____ U.S. ____, 105 S.Ct. 1238, 1240 n. 1 (1985), and that Shearson Lehman enjoys, as it claims, an absolute right to compel arbitration pursuant to sales agreements it entered into with its SPDA customers, this Court does not agree that class treatment is perforce inappropriate as to those claims. The fairness and completeness of class litigation, in contrast to the scattered and fairly random solution suggested by individual arbitration, persuades this Court that fraud claims such as these are often best resolved by class action. Not only are interests of consistency, efficiency and completeness served, but there is also the assurance that most if not all potential claimants will be apprised of their rights and of the named plaintiffs' comparatively inexpensive efforts to vindicate them. This Court finds it hard to believe that any class action defendant so situated would prefer separate arbitration of each of thousands of potential claims that might otherwise be decided by class action at far less transactional cost. At least under the circumstances of this case, arbitration cannot be regarded as a serious alternative to the class action, which is so ideally suited to securities fraud claims.

The standards of Rule 23, at once fair and flexible, reaffirm the known truth that for all its pretensions, law is meant to be practical. The willingness of tweny-four sophisticated broker-dealers, advised by experienced counsel, to settle their companion actions for a record $183 million eloquently bespeaks the appropriateness of class certification among those actions that remain.

Accordingly, plaintiffs' motions for class certification in each of the four litigation tracts is granted. Each class shall be composed of those persons and entities (a) who purchased SPDAs (i) that were issued by National Investors Life Insurance Company and University Life Insurance Company of America and/or reinsured by National Investors Pension Insurance Company, Mt. Hood Pension Insurance Company, National Equity Life Insurance Company, and S & H Life Insurance Company, all of which are affiliated with Baldwin-United Corporation, and (ii) that were purchased through the respective broker-dealer defendants in each such action during

the period January 1, 1979 through July 13, 1983, each in his, her or its individual capacity and any and all collective representatives, assigns, heirs, executors, administrators, custodians, predecessors or successors in interest and any other person having any legal or beneficial interest in any of such SPDAs, and (b) who continued to hold such SPDAs on July 13, 1983.

The respective representatives of the Class as to each of the above-captioned actions shall be and hereby are certified to be as follows:

1. *Linton* v. *Shearson Lehman/American Express, Inc., et al.*, 83 Civ. 8476 (CLB), Alfred Linton and Jerome W. Eichelsbacher;

2. *Erti* v. *Paine Webber Jackson & Curtis, Inc., et al.*, 83 Civ. 9085 (CLB), Vincent Erti, Joseph and Elizabeth Chupko, George and Margaret Ledney, William Neil Aicholtz and Janet Aicholtz, and Genevieve Novicky;

3. *Woods* v. *W.H. Newbold's Sons & Co., Inc., et al.*, 84 Civ. 2235 (CLB), Oscar J. Woods; and

4. *Perel* v. *Rotan Mosle, Inc.*, 84 Civ. 8879, Steven A. Perel.

Settle a formal order on notice, which shall declare the classes as hereinbefore set forth and provide for notice and an opportunity to the members of the classes to exclude themselves.

Dated: White Plains, New York
- June 27, 1986

/s/ CHARLES L. BRIEANT

Charles L. Brieant
U. S. D. J.